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SUBJECT: PANAMA FACES UNCERTAIN ENERGY FUTURE

REF: A. MEXICO 7368

[1](#)B. MEXICO 7466

This is the second part in a two part series on Panama's energy sector.

[1](#)1. SUMMARY (SBU). Major electricity generators estimate that Panama's demand for electricity will exceed supply by 2009. In the absence of investment in additional generating capacity, Panama could face energy shortages. Only plants using higher cost gas-generated electricity could be brought on-line prior to 2009, guaranteeing a steep rise in the cost per kilowatt hour over the next three to five years. Construction of cheaper hydro or coal generated electricity exceed the available timeline. Currently, no new plants of any type are under construction. GOP reluctance to grant long term purchase contracts of more than four years in length has discouraged suppliers of all types from investing in additional capacity. END SUMMARY

SHORT-TERM ELECTRICITY CONTRACTS DISCOURAGE NEW PLANTS

[1](#)2. (U) Panama's electricity market is divided into three parts: Generation, transmission and distribution. There are currently 9 companies engaged in generation, 1 in transmission and 2 in distribution. Although the market was privatized in the late nineties, the GOP retained 49% ownership in the three largest power generators. According to regulation, the GOP is supposed to contract for 100% of the projected demand plus a reserve amount. However, since being burned by high contract prices and low spot market prices in the initial period following privatization, the GOP currently only contracts about 70% of demand and buys the remaining energy at hourly spot market prices. No new power plants have come on-line since 2003 with one existing plant going off-line in 2004.

[1](#)3. (SBU) Former Enron company Bahia Las Minas (BLM), 49% owned by the GOP, operates several energy generating plants using a variety of technologies. One of their plants, however, operates on marine diesel and provides the most expensive energy per kilowatt hour. This plant provides the last marginal energy used during the day but only at contract prices. BLM will not provide additional energy on the spot market because their price per kilowatt hour is the highest. Once that price is on offer, all other providers can sell excess capacity on the spot market cheaper and at a substantial profit allowing BLM to only break even.

[1](#)4. (SBU) BLM General Manager Max Kelly, told Econoff that BLM was prepared to make a \$100 million investment in converting this plant to significantly cheaper coal technology if the GOP would return to 10 year contracts for the output. So far the GOP has declined. BLM faced bankruptcy in April 2005 but negotiated \$45 million in refinancing over the next 7 years. Because the financing arrangements consist of balloon payments, Kelly estimates BLM can survive until 2007 under the current pricing structure before facing default and bankruptcy. If BLM defaults, Kelly expects the GOP might seek to take over BLM's assets and operations.

[1](#)5. (SBU) BLM is also involved in a long running dispute with the GOP regarding customs duties assessed on imported equipment for capital improvements. BLM (and other generators) had a waiver in effect at the time. Despite a favorable ruling in court, no refund (\$1.5 million) has been forthcoming. Instead, the Taxation and Revenue authority (DGI) sought to retroactively overturn these waivers and assess customs duties on other energy companies who imported capital equipment during the same time period. This month, the DGI indicated verbally that it would not be pursuing this matter further but none of the American providers have been formally notified.

[1](#)6. (SBU) AES Panama is also an American Company (49% owned by the GOP) and produces 100% hydropower electricity. General Manager David Sundstrom confirmed BLM's contention that no additional capacity has been built in several years due to the absence of contractual terms of 10 years or more. However, in December, AES Panama secured two 9 year contracts for the period 2009 to 2018. It is not yet clear if the

contractual price is sufficient to incent AES to invest in new capacity or whether this contract will be serviced from AES's existing hydroelectricity plants.

GOP SEEKS REGIONAL SOLUTIONS

17. (SBU) The sharp increase in global fuel prices has prompted several regional energy initiatives. Fortunately, Panama appears to remain uninterested in Venezuela's Petrocaribe initiative nor has there been any activity related to the stalled Puebla to Panama Plan (PPP). However, Panama has enthusiastically responded to President Fox's Mezoamerican Energy Initiative vying for the site of the proposed new refinery (Reftels). However, Panama must await the outcome of the independent feasibility studies and confirmation of financing by the Inter-American Development Bank among others.

COST EFFECTIVE SOLUTIONS ARE LONG TERM

18. Comment (SBU): The division of Panama's energy policy between the Ministry of Economy and Finance (MEF), Ministry of Commerce and Industry (MICI) and the regulatory commission (ER) has fundamentally hindered the GOP's ability to develop long term, coherent energy strategies. To protect consumers and placate voters, the GOP has sought to minimize its short term energy costs. Without an acceptable profit margin, no new investment in this capital intensive industry has been undertaken by the generators. Panama's electricity generators are waiting out GOP willingness to reengage in long term contracts. The feasibility, cost and output from the MezoAmerican Energy Initiative remain to be seen. Regardless, none of the initiatives outlined by the GOM have reliable completion dates and are unlikely to come on-line prior to 2009.

19. Comment cont'd (SBU): When the power runs out, the GOP could be forced to contract for additional capacity on an expensive spot market or to negotiate contracts for short term supply with companies whose only option will be to use expensive energy generation technology. In either case, Panamanian consumers will likely demonize the industry and pressure the GOP to pursue a cap on electricity prices. An uncertain energy supply could dim Panama's increasingly bright economic prospects.

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